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A Guide to Business Structures

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Introduction

Farm business structure is an important aspect of farming, though it is often overlooked. Properly structuring your farm operation can provide managerial, financial and legal advantages. It is important to consider your own financial goals before choosing a structure for your farming operation.

This fact sheet will discuss four different business structures: sole proprietorships, partnerships, LLCs and corporations. Sole proprietorships and partnerships are beneficial for their simplicity, but they leave personal assets at risk. LLCs and corporations reduce personal liability but are more expensive and complex to establish.

This short guide is designed to explain the differences between business structures and help determine the structure that's best for your operation. Establishment documentation and tax forms needed for all structures are briefly discussed, but more detail will be provided in future guides. This guide is for educational purposes and does not serve as legal or financial advice.

Sole Proprietorship

Sole proprietorships are businesses owned by one individual. Legally, the individual and their business are one and the same. Sole proprietorships are the least complex business structure to start; if you have done nothing to start a business for your farm, then you are operating as a sole proprietorship by default. The main benefit of a sole proprietorship is that they are quite simple to establish and maintain, with little paperwork involved.

While sole proprietorships are relatively low maintenance, there are some disadvantages. Since the farm business and individual are legally operating as one, the owner is responsible for all financial and legal obligations for the farm. This puts personal assets, such as your home, personal vehicle and bank accounts at risk.

Taxes

Sole proprietors do not need to apply for an Employer Identification Number (EIN) unless hired labor is used on the farm. Taxes for the farm will be filed on Schedule F, also known as the IRS Form 1040 (See Figure 1). Sole proprietorships are considered a pass-through entity, meaning that all income or losses from the farm will pass through to the owner and taxed as the individual's income. Producers are also liable for self-employment tax if they earn $400 or more from self-employment.

Figure 1. Reporting Income and Expenses on Schedule F.

Part I	**Farm Income—Cash Method.** Complete Parts I and II. (Accrual method. Complete Parts II and III, and Part I, line 9.)				
1a	Sales of purchased livestock and other resale items (see instructions)	1a			
b	Cost or other basis of purchased livestock or other items reported on line 1a	1b			
c	Subtract line 1b from line 1a				1c
2	Sales of livestock, produce, grains, and other products you raised				2
3a	Cooperative distributions (Form(s) 1099-PATR)	3a	3b	Taxable amount	3b
4a	Agricultural program payments (see instructions)	4a	4b	Taxable amount	4b
5a	Commodity Credit Corporation (CCC) loans reported under election				5a
b	CCC loans forfeited	5b	5c	Taxable amount	5c
6	Crop insurance proceeds and federal crop disaster payments (see instructions):				
a	Amount received in 2023	6a	6b	Taxable amount	6b
c	If election to defer to 2024 is attached, check here ☐		6d	Amount deferred from 2022	6d
7	Custom hire (machine work) income				7
8	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)				8
9	**Gross income.** Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50. See instructions				9

Part II	**Farm Expenses—Cash and Accrual Method.** Do not include personal or living expenses. See instructions.				
10	Car and truck expenses (see instructions). Also attach **Form 4562**	10	23	Pension and profit-sharing plans	23
			24	Rent or lease (see instructions):	
11	Chemicals	11	a	Vehicles, machinery, equipment	24a
12	Conservation expenses (see instructions)	12	b	Other (land, animals, etc.)	24b
13	Custom hire (machine work)	13	25	Repairs and maintenance	25
14	Depreciation and section 179 expense (see instructions)	14	26	Seeds and plants	26
			27	Storage and warehousing	27
15	Employee benefit programs other than on line 23	15	28	Supplies	28
			29	Taxes	29
16	Feed	16	30	Utilities	30
17	Fertilizers and lime	17	31	Veterinary, breeding, and medicine	31
18	Freight and trucking	18	32	Other expenses (specify):	
19	Gasoline, fuel, and oil	19	a		32a
20	Insurance (other than health)	20	b		32b
21	Interest (see instructions):		c		32c
a	Mortgage (paid to banks, etc.)	21a	d		32d
b	Other	21b	e		32e
22	Labor hired (less employment credits)	22	f		32f
33	**Total expenses.** Add lines 10 through 32f. If line 32f is negative, see instructions				33
34	**Net farm profit or (loss).** Subtract line 33 from line 9				34

Documentation

As mentioned, sole proprietorships have a simple start-up process, and there is no legal documentation required to start one. Sole proprietorships are best suited for small farms without many assets at risk and are also best if one wants full decision-making authority for the operation. To legally add another decision-maker to the operation, while still operating similarly to a sole proprietorship, one should consider starting a partnership.

General Partnership

General partnerships are like sole proprietorships, with the main difference being the number of owners. Partnerships allow for two or more people to operate a business together. Partnerships have several benefits, one being multiple decision-makers on the farm, and the other being able to combine the capital of multiple people, which can make operating and obtaining credit easier. Certain partnerships also allow for silent partners. A silent partner is a partner who contributes resources (money, land, equipment, etc.) to the farm but does not make operational decisions.

The disadvantages of partnerships include no legal separation between the farm and individuals in the partnership, meaning each partner's personal assets could be at risk, as in sole proprietorships. Additionally, there is a risk associated with working with others; if one partner chooses to not uphold their end of the business deal, the other partners will still be responsible.

Taxes

Partnerships are required to file a Form 1065 (see Figure 2), but taxes are paid on each partner's share of the earnings or losses from the business. Partners determine shares of ownership when starting the business; it can be shared equally or by contributions. For example, if a business has two partners and one partner contributed $750,000 worth of assets while the other contributed $250,000, they might choose to give one partner 75 percent ownership and the other 25 percent as opposed to an even share. The partnership will file one 1065 for the entire operation and the individual share of the profit or loss will be reported on Schedule K-1, Line 1 (see Figure 3). The individual share of profit and loss will be reported on Schedule F, but only if the farm income and expenses were not included on Schedule K-1. Again, partners will be obligated to pay self-employment taxes if they exceed $400 of earnings.

Documentation

The startup of a partnership is relatively simple, with the most important document being the Partnership Agreement. The agreement details, among other things, shares of ownership and responsibilities of partners.

Partnerships are best for farmers who currently do or want to do business with others, perhaps a spouse or family member. Partnerships also help with farm transition and estate planning. If one wishes to pass their share of the partnership to their child after death, they should detail this in the partnership agreement to avoid a dispute that could cause the partnership to dissolve. They are best for small or beginning farmers or farms with minimal assets at risk.

Limited Liability Company (LLC)

A Limited Liability Company (LLC) has a structure similar to partnerships and sole proprietorships. LLCs limit the liability of members

Figure 2. Reporting Farm Income and Expenses on Form 1065.

Caution: Include **only** trade or business income and expenses on lines 1a through 23 below. See instructions for more information.

Income	1a	Gross receipts or sales ____ **b** Less returns and allowances ____ **c** Balance	1c
	2	Cost of goods sold (attach Form 1125-A)	2
	3	Gross profit. Subtract line 2 from line 1c	3
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6
	7	Other income (loss) (attach statement)	7
	8	**Total income (loss).** Combine lines 3 through 7	8
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9
	10	Guaranteed payments to partners	10
	11	Repairs and maintenance	11
	12	Bad debts	12
	13	Rent	13
	14	Taxes and licenses	14
	15	Interest (see instructions)	15
	16a	Depreciation (if required, attach Form 4562) — 16a	
	b	Less depreciation reported on Form 1125-A and elsewhere on return — 16b	16c
	17	Depletion **(Do not deduct oil and gas depletion.)**	17
	18	Retirement plans, etc.	18
	19	Employee benefit programs	19
	20	Energy efficient commercial buildings deduction (attach Form 7205)	20
	21	Other deductions (attach statement)	21
	22	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 21	22
	23	**Ordinary business income (loss).** Subtract line 22 from line 8	23

Figure 3. Reporting Share of Income on Schedule K-1.

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss)	14	Self-employment earnings (loss)
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	15	Credits
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital	16	Schedule K-3 is attached if checked ☐
4c	Total guaranteed payments	17	Alternative minimum tax (AMT) items

while offering an easier establishment than corporations. The main benefit of establishing an LLC is protecting personal assets if the farm experiences financial or legal issues.

Taxes

LLCs are also a pass-through entity, so profits and losses pass directly to the members. However, one can choose to have their LLC taxed as a corporation or a partnership. For simplicity, a producer should consider filing as a partnership. This would require a 1065, Schedule K-1, and for each member to file their own Schedule F (See Figures 1-3). Like sole proprietorships and partnerships, members of an LLC will be obligated to pay self-employment taxes if they generate more than $400 in earnings. A larger LLC operating in a riskier industry may wish to file as a corporation. Tax filing for corporations is described below.

Documentation

To start an LLC, Articles of Organization must be filed with the Secretary of State. This can be completed online and costs $45 to file[1] in Arkansas. Additionally, LLCs require members to create an Operating Agreement detailing shares of ownership, member responsibilities, and specific business operations.

LLCs are more appropriate for farmers interested in limiting their personal liability while maintaining a simple business structure. If the business is high-risk and the members want to protect their personal assets, an LLC structure could be beneficial.

Corporation

A corporation is a legal entity that is legally separated from its members. Since a corporation is its own entity, the process is more complex. Corporations are owned by shareholders, and shareholders receive their share of profits through dividends. A benefit of corporations is the ability to sell stocks of their corporation to earn additional capital.

A disadvantage of corporations is the complexity of establishment and management. Further, if operating as a C-corp, one will likely pay taxes on corporation profits twice, once when the corporation pays taxes, and again when the profits are divided among members.

There are two major types of corporations to consider when establishing one: C corps and S corps. C corps must file corporate taxes and the corporation itself is responsible for paying those taxes. S corps are pass-through entities, so the corporation's owners pay taxes through individual tax returns. As mentioned, C-corps face the disadvantage of double taxation, but S-corps do not have this problem.

[1] This website provides the guidelines and process for establishing a new business in Arkansas: https://www.sos.arkansas.gov/business-commercial-services-bcs/for-new-business.

Figure 4. Reporting Income and Expenses on Form 1120.

Income	1a	Gross receipts or sales	1a		
	b	Returns and allowances	1b		
	c	Balance. Subtract line 1b from line 1a		1c	
	2	Cost of goods sold (attach Form 1125-A)		2	
	3	Gross profit. Subtract line 2 from line 1c		3	
	4	Dividends and inclusions (Schedule C, line 23)		4	
	5	Interest		5	
	6	Gross rents		6	
	7	Gross royalties		7	
	8	Capital gain net income (attach Schedule D (Form 1120))		8	
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)		9	
	10	Other income (see instructions—attach statement)		10	
	11	**Total income.** Add lines 3 through 10		11	
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions—attach Form 1125-E)		12	
	13	Salaries and wages (less employment credits)		13	
	14	Repairs and maintenance		14	
	15	Bad debts		15	
	16	Rents		16	
	17	Taxes and licenses		17	
	18	Interest (see instructions)		18	
	19	Charitable contributions		19	
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)		20	
	21	Depletion		21	
	22	Advertising		22	
	23	Pension, profit-sharing, etc., plans		23	
	24	Employee benefit programs		24	
	25	Energy efficient commercial buildings deduction (attach Form 7205)		25	
	26	Other deductions (attach statement)		26	
	27	**Total deductions.** Add lines 12 through 26		27	
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.		28	
	29a	Net operating loss deduction (see instructions)	29a		
	b	Special deductions (Schedule C, line 24)	29b		
	c	Add lines 29a and 29b		29c	

Figure 5. Reporting Income and Expenses on Form 1020S

Caution: Include **only** trade or business income and expenses on lines 1a through 22. See the instructions for more information.

Income	1a	Gross receipts or sales ____ **b** Less returns and allowances ____ **c** Balance	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Net gain (loss) from Form 4797, line 17 (attach Form 4797)	4	
	5	Other income (loss) (see instructions—attach statement)	5	
	6	**Total income (loss).** Add lines 3 through 5	6	
Deductions (see instructions for limitations)	7	Compensation of officers (see instructions—attach Form 1125-E)	7	
	8	Salaries and wages (less employment credits)	8	
	9	Repairs and maintenance	9	
	10	Bad debts	10	
	11	Rents	11	
	12	Taxes and licenses	12	
	13	Interest (see instructions)	13	
	14	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	14	
	15	Depletion **(Do not deduct oil and gas depletion.)**	15	
	16	Advertising	16	
	17	Pension, profit-sharing, etc., plans	17	
	18	Employee benefit programs	18	
	19	Energy efficient commercial buildings deduction (attach Form 7205)	19	
	20	Other deductions (attach statement)	20	
	21	**Total deductions.** Add lines 7 through 20	21	
	22	**Ordinary business income (loss).** Subtract line 21 from line 6	22	

Taxes

Corporations report taxes on the 1120, or 1120S for an S-corp (see Figures 4 and 5). S-corps are also required to file a Schedule K-1 (Figure 3) to report shares of ownership. Then, owners must file a Schedule F (Figure 1) to report their earnings or losses.

Documentation

Corporations must obtain a new Tax Identification Number (TIN) and file Articles of Incorporation[1]. Corporations also need Bylaws and Stock Certificates if they plan to sell stock.

Corporations are good for very large, high-risk businesses. Since the individual and the business are separate legal entities, there is no risk of losing personal assets if the corporation fails. For a business operating on a very large scale or one with a high chance of becoming delinquent on financing, for example, this could be beneficial. Businesses low on capital that need to raise funds could benefit from a corporation because it allows for income to be generated from the sale of stock; however, this requires that a corporation enter the public sector, which creates additional filing requirements.

Conclusion

Choosing and establishing a business structure for your farm can be a daunting task; however, it can be worth the time for improved risk management, financial security, and organization. Each business structure offers different advantages to your operation. Although there is no perfect business structure, it is important to thoroughly research each business structure and consider personal needs. This helps ensure choosing the best business for yourself and your operation. While this fact sheet serves as a brief overview of business structures, future publications will describe tax and establishment documentation in detail.

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